The Cause and Prevention

OF

BANK DEFALCATIONS

By

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PREFACE

MANY books have been written on the subjects of bank examinations, bank defalcations and on the duties of bank directors, but in this volume, which might be called a "straight-from-the-shoulder" talk to bank directors, the writer has endeavored to produce the sum total of these subjects. The purpose in summing up at this time is the idea, I might say the hope, of bringing home to directors a full realization of their duties, particularly in regard to defalcations.

Disregarding their personal responsibility and liability, it must also be remembered that bank directors are public officers, and, as such, should not betray the confidence placed in them by the public, which some of them unintentionally seem

to do. Unfortunately many of these men do not recognize conditions in their institutions which invite and encourage defalcations. Irregular practices, however small, which are dangerous, and have been known to breed crime, are pointed out at this time so as they may be guarded against.

The writing of this volume was prompted by the many questions asked by bank directors, who were shrewd enough to realize that there was much "behind the scenes" in banking routine with which they were unfamiliar. That these men may benefit from the writer's experience and their impressions be lasting, resulting not only in personal gain to themselves but in the attainment of a great public good, is the author's aim.

MARTIN K. FOWLER.

Newark, N. J., July 1, 1924.

BANK DEFALCATIONS

IT may be surprising to many readers to know that there are hundreds of men ruined and several million dollars lost annually through bank defalcations, and these figures show a dangerous and unnecessary increase every year. One surety company alone showed a net loss of five hundred thousand ($500,000) dollars for the year 1922 on bank defalcations only. Considering the number of surety companies issuing this form of protection, and the many losses sustained by directors over and above the amount of their surety bond, together with the costs to the Federal and various state governments, an estimate of an annual loss of five million ($5,000,000) dollars would seem indeed small.

An inspection of newspaper files in any of the public libraries might cause one to think that this estimate should at least be doubled and possibly trebled. In addition to the losses just referred to are the cases where the stockholders, and even the depositors, must bear part of some particular loss.

Glancing at the costs to the Federal Government for the investigation and prosecution of hundreds of cases every year, some idea may be had from a rough estimate made by a government official. A United States attorney was engaged in prosecuting a case, the trial of which lasted about a week. There was nothing uncommon about this particular case nor was this attorney one who was given to exaggeration, as his reply indicated. He was asked to state a figure which, in his opinion, would represent the cost to the Government for the investigation and prosecution of the case in which he was

engaged. He replied that this was rather an unfair question to expect him to answer, but after discussing the question for a few minutes, he stated that he was reasonably sure it had cost several thousand dollars. Other attorneys and court attaches in the court at the time made rough estimates of ten thousand ($10,000) dollars.

The report of the Attorney General of the United States for the fiscal year of 1922 shows that three hundred and thirty-eight (338) cases were reported to his office during that period. The total number of cases cannot be multiplied by the estimated cost of the individual case just referred to, as some of them may have been disposed of with pleas of guilty and, therefore, little or no expense outside of the regular legal machinery, the maintenance of which is also a cost to the Government. On the other hand, many of these cases may have cost more than ten thousand

dollars, the estimated cost of the individual case referred to. There does not seem to be any way of obtaining the figures on the actual cost of any particular case.

An idea of these costs may be obtained by a review of what actually happens in the case of a defalcation in a national bank. The regular Treasury Department examiners are usually responsible for the first disclosure of an irregularity, sometimes merely "scratching the surface". This irregularity is reported to the Attorney General's office and from there it goes to the Department of Justice. This department sends out men trained in banking, accounting and investigation, and with a knowledge of court procedure and what constitutes evidence. These men are given ample authority to "dig to the very bottom" and there is no limit placed on the time to be consumed or the expense to the Government. The criminal investigation is then begun to fix responsibility on

all involved and to collect evidence preparatory to prosecution. Some of these investigations will run along for many months or a year and cost several thousand dollars in salaries and expenses. Then the case is presented to a grand jury and then tried before a petty jury, and sometimes retried. Some of these trials will last a week or ten days and require the bringing of witnesses from many different parts of the country at the expense of the Government.

Just consider the number of investigations and trials that are in progress year after year and you may imagine this enormous cost.

The Attorney General's report shows further that the Government collected fines totalling $14,550 for the year on violations of the National Banking Act. Possibly this small sum would remunerate the Government for the prosecution of a few cases, and the others would represent

a total loss. This report also shows that sentences aggregating 116 years, 4 months and 9 days were presented to bank defaulters. This would seem to indicate that the public must stand the cost of supporting certain individuals during extended "vacations" who are well able to and should be supporting themselves.

We must also consider the unknown costs to the various state governments for the prosecution of hundreds of cases in state banks and trust companies every year. These cases are handled by the local and state authorities, and paid for directly by them. In the last analysis, however, whether it be a Federal or state case, the public must shoulder the costs.

Last, but by no means least, we have the great human loss, the ruination of the lives of hundreds of young men every year, men who were not entirely to blame, not morally so, at any rate, and yet they have been branded for life. Year after

year more bank men drift from useful occupations, where they are a benefit to society, to the penal institutions, where they are supported by society. It matters not if they are penalized lightly or severely, their lives are ruined. Many simply join the "down-and-out" class where they are a positive menace to society. The chances of their being of further use to themselves or anyone else are indeed slim. Possibly a death sentence in many cases would be an act of mercy.

By Whom Is this Loss Borne?

At a glance it would seem that most of this loss was borne by the surety companies, and, therefore, they alone should be concerned. This view of the situation is not only erroneous but dangerous, inasmuch as human nature is more or less selfish and the attitude of "who wants to help the other fellow save" might prevail and

thereby tend to increase and not decrease the number of embezzlements.

It is understood by almost everyone that more cannot be taken from a corporation than goes into it, hence the rates on fidelity bonds must be based upon actual losses. While the surety companies may appear to be the direct losers, they are actually only the agents in distributing these losses, which are spread out and handed back to the public in another form.

As must needs be, all great losses are absorbed by the public, therefore it becomes the duty, not alone of the surety companies but of every public-spirited citizen and organization in the country, to give aid and encouragement in helping to check this great waste.

When the public realize that they are the real losers, when they so often read of bank defalcations and when they understand further that many of these losses could have been prevented by diligent

bank directors, then we may expect an outburst of public fury against those directors in whose institutions defalcations occur. Then, only, will some directors fear the occurrence of a defalcation.

It frequently happens that directors and even stockholders are compelled to make up losses which exceed the amount of the surety bond. If this were more often the case the number of defalcations would be considerably reduced. Occasionally an institution is forced to close its doors as a result of irregular practices. These are cases where the public usually stand a large portion of the loss directly.

"Why Not Let the Surety Companies Worry?"

The bankers who take this attitude, and unfortunately there are many of them, are the very ones responsible for a large

majority of the defalcations. They are, furthermore, responsible for helping to increase the population of our penal institutions, not to mention the ruination of many young men.

Just think of a large bank in which a defalcation of approximately $50,000 occurred, permitting the same conditions which furnished the opportunity for this theft to exist for a whole year after. When the attention of the officers of this bank was called to this negligence they stated that they intended to change that dangerous custom. Banks like this should be compelled to make these changes forthwith, but of course the surety company made good once and will make good again, so why worry or even hurry.

Surety companies are not charitable institutions, and, as stated before, they are not really losing anything.

Bank directors who think they are fooling these companies are really fooling

themselves and the public whom they represent.

Directors who take this view, caring not for prevention but relying solely on their surety protection, should stop to consider the size of a possible defalcation. What guarantee have they that their defaulter, if they should have one, will keep his theft down to the amount of the bond? Hundreds of directors have had to dig and scratch for every dollar on which they could lay their hands, money for which they had worked hard and saved, to make good defalcations which were greater than their surety bond covered. They have learned their lesson, although late.

How Much of this Great Loss Might Be Saved?

After much investigation the writer believes that at least one-half of the losses caused by bank defalcations could be

spared if all bank directors throughout the country were "up to their jobs". There is no doubt but that fifty per cent. of the defalcations are a direct result of faulty management. The responsibility is, therefore, fixed on the directors as a class, they being in supreme command of the management of their institutions. There are thousands of these men who are directors in name only, masters in their own line of business, no doubt, but totally unfamiliar with banking routine and, therefore, not fully qualified to direct the safeguarding of other peoples' money. It is true that many of these men are extremely busy with their own business and cannot give the bank much of their time. They have accepted a large responsibility, however, whether they realize it or not, and should not dare to be derelict in so great a duty to themselves and to the public. One of the purposes of this volume is to put these busy men on notice of their duty,

to point out danger signals, and to tell them, briefly, how to be on guard, without using much of their time. This book is intended to be a respectful effort to induce bank directors to apply to the conduct of a bank a little of the common sense which made their own business successful.

What Effort Is Being Made to Check These Losses?

It does seem as though it were about time some serious thought was given to this situation. It is hard to believe that in our modern and progressive country of over one hundred million people, whose very watchwords are efficiency and economy, that no direct and concerted effort has been made to check this tremendous waste of men and money.

This condition is not improving as time goes on, but is rapidly becoming worse, and yet no campaign worthy of

being called an effort is in force to "plug" these leaks.

Serious as this situation is the fact that so many of these defalcations could easily be prevented, and the losses attached thereto spared if a real effort in the right direction were made, makes the situation the more flagrant.

The surety companies would be the logical interests to carry on a campaign of this nature because they alone could insist upon reforms, if education were unavailing. These companies would be doing a public work and should be aided and supported in so doing whole-heartedly by the national and state governments.

We are living in an age of reforms of every nature—reforms by legislation and by education, some successful and some not.

Success in undertaking to bring about a reformation in regard to the causes of

bank defalcations would not be a remote possibility.

Bank directors, as a class, are most all real men enough to see their duty and do it, so why wait for any campaign or reform movement to force their hands?

How Many Cases Are Successfully Prosecuted?

Transcript from the report of the Attorney General of the United States for the fiscal year ending June 30, 1922:

Offense — National Banking Act: Cases reported, 338; closed, 108; pending, 93; indictments, 71; recoveries, . . ; fines, $14,550; sentences, 116 years, 4 months, 9 days.

The report from the Comptroller of the Currency for the year ending Oct. 31, 1922, shows that a total of 52 convictions were obtained for violations of the national banking laws; 26 of these cases were

bank officers and 26 employees below the rank of cashier. The longest sentence given was six years and one day and the shortest one day in the custody of the United States marshal. Seven cases were penalized with fines only.

It will be noted that the two reports referred to above do not reconcile in any way and this may be due, in great part, to the difference in the periods covered. Considering these reports individually they each show the difficulty in obtaining convictions and the mild penalties inflicted.

Bank defaulters are usually of sufficient intelligence to prepare a defense as they go along pilfering, and this makes it difficult to obtain convictions. If the juries would only consider the results of a man's acts, and not the acts alone, there would be more convictions. A man's intent can best be judged by the results of his acts.

Most bank trials must be based on

documentary evidence, and it is hard for the ordinary jury to weigh the importance of such evidence. Juries like to hear a witness testify that he saw the defendant steal money before they will convict. It is rare indeed that eye witnesses to these acts can be found. It is a tax upon the mental capacity of a good many juries to follow through many involved financial transactions and at the same time see the streak of criminal intent. From the writer's observations it would seem that the most flagrant cases, where the judge would actually tell the juries to bring in verdicts of guilty, they would do so, but in cases where the judge really wished the jury to decide and so charged them, by leaning neither to the side of the defense nor prosecution, they would act like children without a leader or without minds of their own and play safe to their own conscience by acquitting or disagreeing.

Much of this kind of evidence seems to go "over the heads" of many jurors, and they sit at ease until the last day of the trial, depending on the charge by the court to help them to a decision. If the charge by the court is neutral, it is safe to say there will be no conviction. And so the defaulters multiply.

Would More Severe Penalties Be the Remedy?

Yes and no. In the locality in which the defalcation had occurred and where the prosecution is closely followed, a severe penalty would undoubtedly prevent the spread of the "disease" to adjacent banks, as is now often the case. The most severe penalties would not succeed, however, in bringing about a general reduction in the number of defalcations. This condition can only be attained by the directors

themselves. No matter how severely one unfortunate is punished there will always be someone who has not heard of this severe penalty or who will take a long chance regardless. Our present-day mode of living and the weaknesses of human nature will perhaps always tend to create the desire in some to pilfer, notwithstanding the consequences. As long as we can never eliminate but just retard the desire, then our only hope is to stamp out the opportunity. Remember the bank defaulter never intends to steal; he actually believes at first that he is just "borrowing". Then why would severe penalties to others deter a man from "borrowing"? Directors must see that the routine of their bank is conducted so that officers and clerks do not have an opportunity to "borrow". This subject is referred to further in another section under the heading of "Prevention vs. Prosecution".

Prevention vs. Prosecution

The strongest attack that can be made against defalcations is to forestall the same with preventive measures; therefore, prevention should be the policy, the very keynote of every financial institution. The most severe and successful prosecution is far outbalanced by prevention, as nothing can be gained from prosecution. For the purpose of comparison, I think the reader will concede that the most successful war is a failure. A prosecution means a great loss, sometimes for the defaulter, but always for the bank. Some may say, why worry about these things until they happen, and then we will prosecute with every power at our command. Just figure the number of years with which the defaulter is penalized against the time it will take a bank to outlive the unfavorable publicity, loss of accounts and often the loss of actual money over and

above the amount of the surety bond, and judge for yourself who the real loser is in a defalcation. Try to visualize a bank defalcation from my attempted description and again decide for yourself if prevention would not be far more profitable than the most severe and successful prosecution. The writer believes that bank defaulters should be prosecuted to the full limit of the law and dealt with more severely than most other criminals, but feels that if more thought is given to the prevention of defalcations the necessity of prosecutions will be reduced to a minimum.

In the Federal statutes which govern national banks the penalty for violation of the banking laws was formerly a minimum of five years, and our defalcations were few, but today the law requires only a maximum of five years and a minimum at the discretion of the trial judge, and our defalcations are numerous. I do not wish to criticize our laws and judges, but

I have seen some defaulters go scot free—no prison term at all, simply a fine. One case in particular I have in mind is that of a bank officer who misappropriated approximately fifty thousand ($50,000) dollars and was penalized with the enormous fine of five hundred ($500) dollars and not a single day in jail. Just one year later a junior officer in this same institution was arrested for an irregularity. I mention the law in this regard for the purpose of warning bankers not to depend upon the public laws for satisfaction or, I might say, vengeance for their loss in the case of a defalcation, for they may be disagreeably surprised. I have seen cases where bank men have violated the banking laws most flagrantly, where their very acts spoke for themselves, and where every single charge made by the prosecuting authorities was supported by strong documentary evidence, and yet juries bring in verdicts of "not guilty". There is no tell-

ing what a trial jury will do. I hope you will draw the inference that prosecution at its best is far from satisfying.

Bank directors, make your own laws for your particular institution, and have in mind while framing these rules and regulations the idea of prevention and not prosecution.

It is inadvisable to extend sympathy in any form to one actually involved in a bank defalcation. My arguments in this book are for the purpose of eliminating prosecution as far as possible by preventing the defalcations, but if they do occur, regardless of precautions, then by all means prosecute. Do not mislead yourself by thinking that the defalcation with which you are actually acquainted is any different or that there is any more excuse for it than thousands of others. Do not feel that the person involved, even though he may be a lifelong acquaintance and even though he may be a victim of circum-

stances, should be treated any differently than a common thief. Remember, it is not your money he has stolen, but possibly the life savings of many poor people, the all-in-all of widows and children. His pilfering, as far as he knows or cares, might have caused the bank to close. Did he show any sympathy to the depositors or consider them in any way when he helped himself to satisfy his personal greed? To extend any consideration to a bank defaulter, regardless of the person or the circumstances, makes you a friend in his eyes while the sword hangs over his head, but he is sure to consider you a weakling when he is entirely out of trouble. Force the defaulter to respect you as he has not respected the laws by demanding a vigorous prosecution.

What Is a Defaulter?

It is the writer's contention that the so-called natural-born thief seldom, if

ever, enters the employ of a bank, but that the ordinary bank defaulter is an honest man who becomes a thief after he obtains bank employment. It must be remembered that the bank defaulter seldom intends to steal, according to his own way of thinking, but merely imagines that he is forced to "borrow". His past life, family connections and references mean nothing after he is employed in so far as a guarantee against defaulting is concerned. If he is seized with the desire, usually under pressure, and the opportunity is present, then he will, in all likelihood, default. He feels that his back is to the wall and to "borrow" money is the only way, having come to this conclusion because he has seen the opportunity to "borrow".

What Is the Cause of a Defalcation?

The usual causes of defalcations, of which we hear so often, such as gambling,

business losses, bad associations, etc., are not the whole causes. They may be classed as the desire. Opportunity, which is the other cause, must also be present. The desire or the pressure to use money for any of the so-called "causes" of defalcations would in itself not be dangerous but for the fact that it couples up with a state of mind bordering on temptation created by loose methods, lack of preventive measures, lack of discipline, etc. In other words, owing to some particular looseness in the machinery of the bank, *the opportunity* has been noticed, possibly subconsciously so, and lies dormant in mind only to be awakened by the real or imaginary pressure for money. We do not know which of the two causes of defalcations—desire or opportunity — predominates, that is to say, whether the desire seeks the opportunity or vice versa. It is not within the province of man to know just what was in the minds of all defaulters immedi-

ately prior to their rash acts. The writer, however, has had many heart-to-heart talks with bank defaulters while they were in a communicative mood and has come to the conclusion that the responsibility for defalcations is evenly divided between desire and opportunity.

How Are We to Prevent Defalcations?

To prevent defalcations entirely we would have to eliminate both the desire and the opportunity. It must be plain, then, that we can never hope to prevent defalcations entirely, for desire pertains to the human element, where opportunity is chiefly the physical feature. As long as we have human nature to deal with, the desire is bound to crop up from time to time. We cannot prevent the creation of desire, but we can guard against it and retard its growth by continually attacking it. We can eliminate the opportunity once and for all time. This is,

without doubt, a physical possibility. When we have won our fight against the opportunity with the weapon of prevention, then we will have been successful in reducing defalcations to possibly one-half their present number. Remember that the opportunity comes into existence with the natural growth of the bank, and unless the routine is tightened, as the bank grows, so the opportunity will grow.

The Desire and How to Attack It

We have all heard, more or less, about the desire or the pressure to misappropriate bank funds on the part of many bank employees. The newspapers refer repeatedly to stock market speculation, undesirable companions, unsuccessful business ventures, extravagance, etc., as being the causes of the many defalcations about which they write. The press does not go into detail, however, to say that the par-

ticular "cause" to which they referred was not the complete cause, but just one-half of it, and, therefore, only the desire. Possibly the newspaper writers do not know that the other half of the real cause was the opportunity to execute this desire. No man can be excused for allowing himself to be overcome by this desire; on the other hand, no director should permit the opportunity to exist in his institution by means of which the desire is fulfilled. What would happen if the newspaper told all the facts in many cases, and, in addition to the damaging remarks concerning the defaulter, they added, "the routine conditions in that bank were worse than in a country grocery store," or "the example set for this young man by his superior officers was such that an ultimate defalcation was only to be expected," or "the bank actually invited its employees to steal"? Such comments as those would undoubtedly wreck many institutions, yet why

should they be protected? The defaulter's life is wrecked; he was spared no publicity; some will say that the public money on deposit should be considered. True enough, but what guarantee has the public that the conditions in that institution will be corrected when the storm subsides? The public might be spared a great loss if the institution in which a large defalcation occurs was closed immediately.

It must be understood that the attack against the desire as referred to is, at its best, weak because this is indeed a one-sided battle. Our real fight must be to eliminate the opportunity. Do not lose sight of the fact, however, that if the causes which lead up to or precede the desire are properly guarded against it would be a great aid in reducing the number of defalcations even though the opportunity did exist.

The general public well know that stock market operations are extremely

dangerous, particularly for a man in a trusted position. Statistics prove beyond a doubt that this form of gambling has caused the desire to default in a very large majority of all cases on record. Yet there are possibly thousands of directors who are ignorant as to whether any of their employees are interested in the stock market, and would not take the trouble to find out. Yet these directors will make great efforts to have the public bring in more and more funds of which they are to be the custodians. There are many directors who wink at the practice and others who openly discuss stock market operations with their bank employees.

The writer has seen cases where the entire working force of banks, including all officers and every clerk down to the janitor were in "pools," as they called it, to "play" the market. Just think of it—think of your wife, if she were a widow, or your mother having all the money or secu-

rities they possess in an institution of this kind! If you permit anyone to put money in your bank when conditions of this nature exist you are certainly committing a major crime for which you may have to answer.

Before it is too late, and before any of your employees fall into the clutches of the stock market, decide to become a little inquisitive. Watch the man who is forever studying the quotation page of the daily newspaper and the man who receives the chance circular from a brokerage house, even though it is apparently a mere circular. Of course, his name may have gotten on the "sucker list" through no fault of his own or the circular may have reached him at the bank through an error on the part of the brokers in not sending it to another address. Keep your eye on the man who makes and receives frequent telephone calls and learn the source and destination of these calls. An inquiry or

two at this time may save you and others a fortune. Of course the officer delegated to purchase securities for the account of the bank or its customers must keep himself familiar with the moves of the security market. This must be taken into consideration. This officer, even though he be above suspicion, should not be permitted to operate on the market for his own account. If this officer favors one particular bond house or salesman with the bank's patronage his reason for so doing should be inquired into. If this bond house representative is a personal friend of his, this should warrant further inquiry.

It would be a difficult matter to instruct directors how to guard against or attack the desire other than to say they should keep in close personal touch with their employees so that they will be in a position to attack the cause for the desire before the desire itself is created. This would be an easy matter in a small bank

and in the large institution a personnel department or manager should be relied upon for this work. The causes which precede the desire are well known, but to know whether any employee was in the grip of one of these causes it would be necessary to know something about his private affairs—how he spent his spare time, etc. The active officers can easily keep in personal touch with the employees by reason of their close association, where there are not many employees. The directors should remember, however, that officers, just as frequently as clerks, drift into positions which cause them to be seized with the desire. Directors should not fear being considered "over-inquisitive," for in this attitude they are fulfilling their duty and demonstrating that their public responsibility is not too large for them. Remember that a defalcation seldom occurs in an institution where there is at

least one "over-inquisitive" director on the board.

The private life of officers and clerks cannot safely be ignored. If you were going to entrust several thousand dollars in cash or negotiable securities, your own property, with someone to take care of for you, would that person be one who was scratching to make both ends meet, or one who gambled, kept bad company or had other undesirable habits? Of course not. Then why expect the public to take a chance like that? You may say that the public are not taking any chances of this kind in your institution; that is a very nice way for directors to feel, but while statements of this kind are generally assumptions, they should be founded on facts as a result of the directors' own investigations.

Do not try to grind bank employees down to starvation wages. Remember they have to live as well as stockholders

and that they, too, have expenses to meet. Stockholders have their money invested, and employees have their lives invested in the business. Give them their pro rata share of what they are earning as interest on their lives invested. Pay them a fair living wage in keeping with the times, plus enough extra to create a surplus. Then cull out those who do not save, and if after investigation the reason is found to be extravagance, replace them with others who are more thrifty and more reliable. This same advice should apply to those who are forever borrowing from their fellow workers. Watch the officer or employee who is over friendly with one special customer, and if some particular customer chats too long at a teller's window find out the reason for it. People don't usually waste their time for nothing. Pay particular attention to the officer or clerk who is interested directly or indirectly in some outside business enterprise. Look carefully over

every transaction affecting this enterprise. The man whose domestic relations are not running smoothly should also come under close scrutiny. Encourage your employees to purchase stock in their institution, aid them by offering easy payments. This will give you a line on those who save and those who do not, besides being an obvious benefit to the institution. Encourage your employees to open checking accounts in other banks, friendly institutions, to pay their current expenses. An occasional inspection of these vouchers is one of the best ways to get a line on a man's private life. Make it a hard and fast rule not to allow the overdrawing of any account no matter who the customer may be, and do not allow any employee to pay against uncollected checks except on authority from an officer for each particular item.

Keep your bookkeepers away from customers and the telephone as much as possible. They are a part of the inner

workings of the bank, and business with them should be done through the officers. Do not allow officers to make loans personally to any customers of the bank.

Remember that the desire is not always a result of some personal pressure upon the defaulter. Often an officer or employee finds the desire thrust upon him owing to bad customs, such as tellers making good differences, "shaving notes," etc., or the over-accommodation of customers, such as permitting check kites and many other practices, some of which follow the acceptance of gratuities by employees.

Stock Market Operations

Wall Street has been described as a street with a river on one end and a graveyard on the other. Whoever described "The Street" in this way, where fortunes are seldom won but often lost, must have had in mind the fate of many bank em-

ployees. Frequently a bank employee will try to justify his stock trading to himself or to others when called upon for an explanation by stating that he is not speculating but merely investing. Close examination of his operations will generally reveal that what he is really doing is just plain ordinary trading in the stock market. After all, what is the difference between speculating or investing, as he calls it, for in one instance he borrows from the broker and in the other he borrows from other sources. Even if he does use his own money he is playing the worst kind of a gambling game, and heavy losses may cause him to borrow or even steal for the purpose of playing the game further in hope of getting back some of the money which he feels Wall Street has taken from him. The few-and-far-between individuals who will take their own money, for which they worked hard and saved by the greatest sacrifices, certainly are not fit

bank employees when they risk these savings in operations with which they are unfamiliar. Bank clerks are not usually in this class. They try to finance themselves in other ways. A peculiar thing about a bank clerk financing himself illegitimately to trade in the stock market is the fact that few, if any, of them ever have any intention of actually stealing. They all feel that they are just "borrowing" the money and are positive that they will not only win enough to pay it back but will also show a handsome profit to themselves. I have known these men to be many thousands to the bad with no possible chance of repaying the "debt," and still found them to be very optimistic of the future right up to the very minute of their arrest. They then console themselves by feeling that it is the fault of the authorities that they lost, and that if they had not been arrested just when they were everything would have turned out well. In

speaking of bank employees under this heading the writer means to include every junior and executive officer connected with the bank in an active capacity. By far the larger number of those who fall victims to this game are officers. They are inclined to have more confidence in themselves than the younger clerks and their success in attaining a higher position sometimes creates a large opinion as to their ability. Little do they realize that they are mere nothings in the speculative world which is infested with many hungry wolves who are constantly in search of the acquaintance of men in trusted positions. These parasites are smooth and clever and it is impossible to beat them at their own game. They are not clever enough, however, to beat the market themselves, in fact, it is a question whether anyone is really clever enough for this. This element does not try to beat the market—they know better—so confine their efforts

to beating easy victims by using the market as a cloak. The reader must not assume for a minute that all stock operators are crooked, for this is far from being the truth. The responsible and reputable brokers are in the large majority and many of these men are of the very highest character—gentlemen in every sense of the word. These men, however, are not reaching out for the business of bank clerks; they not only do not encourage it, but positively refuse to carry such accounts. If a broker knowingly carries an account of a bank clerk directly or indirectly he is not only violating the rules of the New York Stock Exchange for which the penalty is severe, but he is placing himself on record as one of the many undesirables which the real backbone of Wall Street has been trying to eliminate. These brokers are not members of the New York Stock Exchange, as the high character of this institution does not permit of any

practices which would be justly criticized. The writer has known cases, however, where bank clerks have opened accounts with brokers who were members of the Exchange, by using assumed names and by operating under the names of relatives, etc. The brokers in this instance were of the very highest character, but were deceived into accepting these accounts by one of their own employees who could not be trusted.

A case in mind is where two bank tellers entered into a criminal collusion to play the market with bank funds. They operated with approximately $200,000 of the bank's money for a period of three years, during which time they lost every cent and without the knowledge of anyone connected with the bank. These men were putting transactions through approximately forty different accounts, mostly all of which were under assumed names. Many of their "brokers" would telephone

them at the bank for more margin and other purposes, and even send their messengers to the bank to get cash, which was proof that they knew without any doubt that these men were small salaried bank clerks, and they must have known they were misappropriating the bank's funds when they gambled with ten, fifteen and even twenty thousand dollars at a time. I dare say the majority of these orders were bucketed and the money went into the broker's pocket and not into the market, as was supposed.

Another case in mind is where a "broker" who had obtained thousands of shares of a practically worthless stock through some means without cost to himself encouraged and induced a bank clerk to buy this stock. He told the clerk that he was trying to buy all he could as it was a sure thing. He did not tell him that he then owned fifty thousand shares. He fanned this young man's enthusiasm

to such an extent that he placed many orders through other brokers to buy. This "friend broker" was unloading on the young man through these other brokers, and the bank clerk eventually found himself the possessor of these fifty thousand shares costing the bank about $100,000.

These so-called brokers have high salaried men in their employ who are smooth talkers and are well dressed and mix around socially in hope of meeting easy victims. They are known as "new business men". They will often open bank accounts and deposit substantial amounts, dropping a word now and then to a teller or a junior officer as to the profits they are making in stock trades. They will lead on the teller, and oftentimes the officers of a bank, very gradually and finally offer suggestions or tips on sure things. It is all done so smoothly and gradually that the victims never become suspicious. They think this tipster is

their friend. Even after the prison gates close on these bank clerks it is impossible to make them understand that this very tipster was responsible for their downfall. Wall Street gambling is fascinating and contagious; when one man plays the game you are almost sure to find one or more of his acquaintances or fellow workers doing the same thing. His enthusiasm bubbles over and he confides in those close to him. They thereupon take a chance on his tip and so it spreads. The safest practice would be to immediately dispense with the services of any bank officer or employee showing any interest in the stock market whatsoever, for this is indeed a danger signal.

Forcing the Desire on Tellers

Many banks through their officers are forcing the desire on their tellers, although they may not realize it, by compelling them to make good cash differences.

The safest policy for a bank to adopt is to treat the money which is their stock in trade as just so much valuable merchandise so far as the employees are concerned. Rules or regulations which bring home to the employees the fact that they are really handling money are dangerous. Although honesty is paramount in the banks throughout the country, there would be a great many more defalcations but for the fact that the money is considered just the same as merchandise by most men who handle it. Young men sometimes fall victims to temptation in the early stages of their banking careers, being dazzled at the sight and touch of vast amounts of cash, simply because they have not learned to consider it as merchandise. The great majority, however, will go on day after day for years handling this "merchandise" faultlessly. If they continually had it in mind that it was real money and realized the power of the large amounts which they

handle, I believe this state of mind would eventually weaken the strongest character. I have known tellers to pay out large sums of money all day long, rarely making an error, yet they counted this cash but once before handing it over the window. These very tellers, after receiving their salary, would count this money three times before placing it in their pockets. The layman might say that these men were more careful of their own money than they were of the money of the bank, but this is not the case. These tellers really looked upon the bank's money as merchandise, unconsciously so, and justifiably depended on their skill in handling it as merchandise. In the same way a driver might throw a package from a truck, feeling confident that it will land right side up, having done the same thing so many times before that he was reasonably certain of the result.

It is very bad practice for a bank to require employees to make good short differences which occur in the regular course of business. This rule will tend to make the employee realize the fact that he is handling real money quicker than anything else in the world. This custom is ridiculous from every point of view. This clerk has certainly not made an error intentionally. If he is repeatedly careless, change his position. The chances are he is not dishonest, for if he were, how foolish it would be to show a shortage when there are so many ways of concealing it. Should this man continue to have shortages and be compelled to make good himself there is bound to come a time when he cannot afford to make good and will be forced to obtain this money in some other way, of which there are many in the best managed institutions. Suppose a young man on a small salary

had made good several shortages and along came an over difference. He would naturally feel that this over difference belonged to him and was a chance to get back some of his money. If this young man's resources were slim at the time he might even consider this over difference as a true one without making a real effort to locate the cause. Right here he commits his first theft. Now we have arrived at another starting point of many defalcations, and surely we cannot conscientiously blame the young man. The loss of money through real clerical errors is one of the hazards of the business and should be borne by the bank. Employees should not be permitted to cash checks for themselves, make change for themselves or to accommodate customers from their own pockets before or after hours under any circumstances. These acts will remind him that the money in his pocket is the same as in the cash drawer. He should

learn to feel that the only real money, as far as he is concerned, is that in his pocket and that the cash drawer contains only valuable merchandise which the bank is holding for others. Under the heading "Kitty" will be found the proper way to adjust short and over differences.

A prominent but narrow-minded bank official tried to argue in favor of having his tellers make good cash shortages. Like many other bank officers it was useless to argue with him, therefore efforts were doubled to prove to him the folly of his argument. These efforts were rewarded by finding hidden away in the vaults of one of his tellers many small envelopes each marked "cash over" on a certain date. These envelopes represented several hundred dollars in over differences, yet they were all empty. Was this money taken out to make good short differences, or was it used for some other purpose by this teller? No one knew, not even this official

just referred to, as no record whatever was kept of cash differences. Further investigation developed that this same teller was guilty of many practices, which were worthy of severe criticism, yet none of these acts made any great impression on the official in question. This teller, if not a defaulter at the time, was surely on the road to become one as a result of a vicious practice and bad management.

"Shaving" Notes

I have found on a number of occasions instances where junior officers and even tellers were in the habit of discounting notes for customers personally and receiving bonuses in lieu thereof, in other words, "shaving notes". This was done for people whose credit did not warrant the bank making them a loan, and being desperately in need of money they were willing to pay well for the accommodation.

To the layman this practice might seem regular inasmuch as the teller was taking a chance with his own money, and it might seem was entitled to make a little extra for himself if he could. After a thorough investigation on these occasions it was revealed that when these practices started it was legitimate enough, however unwise, but requests were made more frequently than these men's personal funds could take care of and the temptation of the bonus was too much for them. They "borrowed" from the bank and loaned this money personally along with their own. These "borrowings" did not show in the form of a shortage in their accounts as they just carried the same along "hung in the air," as it were, until such time as the loans were repaid. One of these tellers explained to me that he made a loan of all the money that he had and when more was sought he refused. The borrower thereupon told him that unless he obtained it he was "lost".

This teller explained that it was not the bonus on the second loan which tempted him to use the bank's money, but the desire to save his own money which he had already advanced. From the foregoing I think it can be readily seen that this is a dangerous practice and that it is a simple matter for an unscrupulous person to force a teller in this position until he has caused a large defalcation. The inspection of this young man's bank account in another bank by one of his directors would have told the story in ample time.

Kiting Checks

Check kiting is indeed a common practice and is often carried on with the full knowlege and consent of one or more officers. It is occasionally permitted upon the instructions of an officer. Sometimes an officer will, after becoming more or less friendly with a customer, be induced to

accommodate this customer to the extent of paying his checks against checks which have just been deposited. Possibly the customer will offer any one of a number of reasonable excuses which would seem to warrant this accommodation. He will obtain the same accommodation at another bank or possibly two other banks and carry on a three-cornered kite, which is, indeed, the most dangerous. In this way he obtains cash to carry on his business, or to simply steal, as the case may be, and offset the same by a series of charges from one bank to another. This process has to keep moving. Sooner or later, however, this movement will stop, and the first bank of the three which breaks this chain by refusing to pay items until they are collected will come out without a loss, but the last bank to take this step is the one which has to carry the bag. Frequently firms or individuals which are hard pressed, or even professional check

kiters, will split the amount they are manipulating into a number of smaller, uneven amounts and will use checks of other people or trade names which they themselves control to miscolor these transactions. Bookkeepers should be instructed not to pay against uncollected items under any circumstances unless initialed by an officer. An examination of the transactions on these accounts which were trying to draw against uncollected items should quickly reveal to the officer whether or not a kite was in force.

Gratuities

It is a violation of the Federal reserve statutes for a bank officer to receive gratuities. There should also be a rule in banks forbidding employees from accepting small favors from customers, which in the eyes of the law might not be presumed to be gratuities, such as cigars, tickets, passes, candy, etc. There is no doubt but

that the recipient of these gratuities is automatically placed under obligations to the giver. He will go out of his way to reciprocate in some small way which, nine times out of ten, will be all right. But the individual who will use this as a stepping stone to warm up to some employee may happen upon the scene. He will gradually increase his gifts and try for a closer acquaintance, which will be followed up by requests for certain accommodation. When he obtains the first accommodation which is not strictly legitimate, he has the bank clerk in his power and can force him to any limits. His system of forcing is related elsewhere. Let the reader just try going to any man behind a cage, whether it be a bank or theatre or a railroad station, and hand in a cigar to the man waiting upon him. The effect is sure to be noted. After all, it is only human nature, but in banks these petty failings of human nature must be guarded against carefully.

Gifts from regular customers at the holiday season of the year are, of course, excepted from this class, but their nature and the donor should be made known to an officer of the bank.

Salary Advances

Banks should not permit tellers to advance money to themselves or other employees on memoranda which is usually carried as a cash item. There are many ways in which a teller can manipulate his own items of this nature and the other employees who do not have access to these items are encouraged in living beyond their means. Of course, there are exceptional cases where an employee has some unusual expense as a result of some misfortune. The bank should take care of these cases with a direct loan, the same as is made to a customer, or an officer should take care of the matter personally.

This advice must not be construed to

mean that the door should be shut to employees who are temporarily "short" and compel them to seek a loan elsewhere, but it does mean that these advances, if made at all, should be kept strictly apart from the bank cash.

I suggest, along these lines, that an officer keep one or two hundred dollars in cash (his own personal funds) in his desk for the accommodation of employees. Let every employee of the bank know of this fund and its purpose, and instruct them to have no hesitancy in borrowing when necessary. The officer would keep a record of these advances. The great difference between a fund of this kind and a "kitty" is obvious to any experienced bank teller.

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It would be superfluous to say more about the causes which create the desire at this time as there are few of us indeed who

have not at least felt the pressure for money at some time in our lives, and if we were strong enough to resist the temptation to satisfy this desire then we should lend our strength to others who may need it. This can best be done by fighting the opportunity so that it will cease to exist, then the pressure or desire on the part of those who are weak must fail to function. Remember that opportunity and desire are co-partners and necessary to each other for the commission of a defalcation.

The Opportunity and How to Eliminate It

It would be a hopeless task to try to prevent bank defalcations by familiarizing bank directors with the many methods employed by defaulters. Many directors would not understand the details of these defalcations, particularly in the involved cases. The writer feels it would not be prudent to publish the details of the many

opportunities already seized upon by those with the desire. There are the young and inexperienced, who might take a chance at imitating, and the older and more experienced unfortunate, who feels he is forced to seize some opportunity, who might use the information to further the ends which we are trying to defeat. It would be similar to donating ammunition to the enemy.

New schemes seem to crop out over night and no two defalcations are exactly alike. The human element is an important factor which must always be taken into consideration, together with the various circumstances pertaining to each particular case.

It would be far more important to advise directors as to the proper and necessary action on their part which would eliminate the opportunity without supporting this advice with details which would show just why this action is essen-

tial. Every defaulter with whom the writer has come in contact has attributed the starting point of his downfall to a desire plus an opportunity, which has been covered by advice in this volume, possibly by one of the "Don'ts," which do not go into detail.

One of the most flagrant opportunities, or it might better be called an "invitation to default," seems to be a condition which is prevalent in many banks today, and that is the improper method of conducting the savings or interest department. In view of the great danger attached to the improper conduct of this department, and the fact that there are so many banks which do not recognize this condition, the writer feels that it would be advisable to explain this opportunity in some detail to directors, trusting that they will see the importance of immediately protecting the funds in this classification.

Savings or Interest Department

There are, I dare say, no bank examiners, and a very few experienced bank employees who do not know that the savings, special or interest department, sometimes called the investment department, is indeed a fertile field for pilfering by reason of its inactivity. Yet the possibility of an examiner detecting a defalcation in this department is quite remote, when systems common to a great many banks at present are employed. The writer has seen instances where banks have been systematically robbed through this department, the specific thefts being large and frequent, covering periods of years, and still they were examined regularly by competent examiners. Although the examiners, in one case in mind, were unjustly compelled to shoulder a large part of the responsibility, the directors were compelled to make restitution and faced the possibility

of grand jury indictments for criminal negligence. I think I am conservative in stating that a large part of the money on deposit in state, national banks and trust companies in this department, and even in some savings banks, is not properly safeguarded. The money is protected from outside sources, of course, and it is probably safe enough also in so far as the depositor is concerned by reason of the directors' liability and the protection from surety companies, but the proper systems are not in use to eliminate the possibilities of a defalcation. Entirely too much dependence is placed on the honesty of small salaried employees. It is an easy matter for a director or even a depositor to determine whether or not the proper system is in use in this department. If the pass book is returned to the customer directly by the teller handling the transaction, then "the door is wide open"; whereas if the pass book goes through other hands before

being returned to the customer, then it may safely be assumed that the proper precautions are being taken. There are a number of proper ways in which to conduct this department and but one wrong way, and, peculiar as it may seem, this is the common way. The writer observed on a visit to a large institution, which is considered by its directors as being defalcation-proof, a system which was elaborate, inasmuch as drawing a network of precautions around honest employees, but the originator was evidently not familiar with the workings of a criminal mind. The book was passed back to the customer by the teller handling the transaction, but a young girl was employed to sit beside the teller and record all transactions, looking over his shoulder or alongside of him as she did so. The rest of this system was equally ridiculous in so far as preventing irregularities is concerned. There never has been a system devised and probably

never will be which is absolutely defalcation-proof, but when a teller hands a book directly back to a customer, without the book actually leaving that department first or going through other hands or having the entry which he made in that book recorded in some way, then it is safe to assume that no precautions whatever are in force. Many of the inmates of our penal institutions would be entertained if it were possible for them to read of the precautionary methods in vogue by some of our banks. The general methods used by defaulters in this department are the withholding of deposit tickets, increasing the amounts of drafts made and forging the same, causing false entries to be made such as the misposting of credits, etc., all of which are explained briefly.

By withholding deposit tickets the teller accepts a deposit, enters the same in the customer's pass book in the regular way, and returns the book directly to the

customer. He does not, however, allow the deposit ticket to go through the regular day's work, but holds it out, seldom, if ever, destroying it, and abstracts a like amount of cash to offset, thereby having no trouble in his daily settlement and little chance of an immediate discovery. By continuing this practice he would eventually run a defalcation up to a very large amount and could float this shortage by practicing substitution, that is, by gradually allowing the tickets held out to go through the work and hold out new tickets in their place. This would lessen the chances of the shortage being detected by a bookkeeper in case of a withdrawal.

By increasing the amount of drafts a teller can simply raise a draft made out by a customer, or, where he makes the draft out himself, he can make it out for a greater amount than the customer wishes to draw. For instance, take the case of a depositor wishing to draw one hundred

dollars. A teller can make this draft for a thousand or raise the draft, if made by the customer, and allow the larger amount to go through the books of the bank. He would, of course, enter a withdrawal of one hundred dollars in the pass book of the customer and actually pay out one hundred dollars; the difference of nine hundred dollars would be abstracted and thereby show no difference in the day's settlement. A defalcation caused in this way could also be floated along indefinitely by substitution. The forging of drafts needs no explanation.

The causing of a false entry to be made in this department is sometimes practiced by an employee changing or putting down a number on a deposit ticket which would be the number of an account in which he was directly or indirectly interested. Instead of holding out the deposit ticket, false entries are sometimes made by a bookkeeper over whom a teller has some

influence, or by a teller himself when he has access to the ledgers. Should an official of the bank just referred to read the foregoing paragraphs he would say that these things could not happen in his bank without collusion. The writer will not argue this point now, but refers the reader to a few words relating to so-called collusion in another section, and he may then draw his own conclusions. As stated before, to place the proper protection around these funds and the surest known way to safeguard against a defalcation is to have the book leave the hands of a teller who is waiting upon the customer. The preferable way is to have the book not only leave the hands of the teller but also to leave his department entirely and be handed back to the customer by another clerk in another department. Then real criminal collusion is necessary for a defalcation. Some banks have the teller hand the book out to the bookkeeping department, and the

credit or debit, as the case may be, is posted in the ledgers directly from the book and the book handed back to the teller and then to the customer. At the end of the day the bookkeeper checks his postings with the credits and debits received from the cages. This method is quite safe and entails no extra help. Another very good system is to pass the book from the teller's cage to another department and have a clerk or one of the bookkeepers enter on a sheet or machine the number of this book, the balance appearing thereon and the current transaction. The work received from the teller's cage at the end of the day must agree with that appearing on the sheet or the machine, as should also the balances on the ledgers. The clerk handling this sheet or machine should be changed occasionally. An officer could, without notice, look at this sheet or at the machine at the end of a day and

see for himself how it checks out. He would actually know before the teller had a chance to prove his cash just how much money that teller should account for. These two methods are, in the opinion of the writer, as near proof against defalcations as it is possible to attain. Furthermore, these methods lessen the chances of dangerous clerical errors, unclaimed deposits and possible law suits, as a continuous audit is always in progress.

In the examination of this department directors or regular examiners should spend some time in comparing pass books as they come in with ledger balances. This is especially important in banks where the system is not similar to that which is here suggested as being safe. This is just as important as running up a total of these balances which shows the bank's liability in this department. A clever defaulter ordinarily would not allow his shortage

to show in the form of an increased liability.

New and unused pass books in this department should be kept under restricted access and locked up with the actual cash upon the close of business. It must be remembered that if these books are left around loose and not locked up at night they may easily fall into the hands of someone who might defraud another bank. Possibly the bank to whom they belonged would have to defend themselves against a suit for damages for not taking better care of their pass books.

The use of cards for this department which is so common at the present time is, in the writer's opinion, none too safe. Loose leaf ledgers with lock binders are preferable. The key to these binders, likewise additional blank sheets, could be kept under the control of an auditior, as these are the little things that count in preventing defalcations.

"The Kitty"

The maintenance of what is commonly known as a "kitty" is as equally dangerous to the bank as the practice of requiring clerks to make good short differences. For those who are not familiar with the term "kitty," it may be described as a surplus fund of money not counted in the bank's cash, usually kept in an envelope or box which does not appear in any way on the books or records of the bank. This fund is made up in part by various loose ends of money "picked up" around the tellers' cages, but consists chiefly of "over" differences. The excuse for this fund is usually to have a reserve for short differences. It is sometimes found that these "kitties" are kept with the knowledge of the officers, who seem to acquiesce in the practice. Little indeed is the knowledge of these officers as to how criminals are made. In some banks

the officers think they have this matter under control when they make rules limiting the amounts to go into the "kitty" and to use therefrom, or require the keeping of a side memorandum book showing the transactions in this fund. Such regulations might be of use to govern children, but for the ordinary bank teller, whose work trains him to be keen, they are ridiculous. It often happens that bank examiners will call the attention of officers to the existence of these "kitties," and explain the dangers attached thereto, only to have the advice entirely disregarded by the officers, who usually think it too small a matter to hold their attention. In some cases the "kitty" is not allowed to grow to large proportions, being credited to profit and loss when it does. This seldom happens, however, as the amounts taken out to make good the differences, and possibly for other purposes, usually keep the "average balance" small. Yet the total trans-

actions in the course of a year, if actually known, might cause alarm.

Who knows, other than those actually handling the "kitty," whether the receipts and disbursements are increasing or decreasing, even if records are kept, which is seldom the case? What is the advantage of these side records if an employee wants to be dishonest? Upon inspection the amount of the "kitty" may not show any change; for example, on Monday the contents may be $10 and on the following Saturday still be $10, yet it may have contained $20 on Wednesday and had $10 abstracted on Friday for a difference or some other purpose. Let us consider a teller of strong character—one who could resist any temptation and would not intentionally commit a wrong for any purpose. Suppose that he has a small balance in the "kitty" and a legitimate short difference occurs which wipes out the balance. He then feels he has no reserve with

which to offset the next shortage and is possibly due for a reprimand on the next occurrence. He then, of course, makes every effort to prevent another short difference, but possibly he will not be quite so careful as to an over difference, as he has in mind the hope of building up a reserve in the "kitty," honestly, of course. Right here is where this strong character weakens. He shows an over difference and feels relieved, but does he make an honest effort to locate this difference and see that the proper person receives credit for the same? He may or he may not, but from my observation I believe the chances are he will deposit this over difference in the "kitty" with no wrong intentions, as he feels that the rightful owner will probably put in a claim and then he can make good from the "kitty". What often happens, however, is that the rightful owner never claims it; along comes another short difference and the reserve in the "kitty" is

again wiped out. This teller has, I believe, with no intent committed a moral, if not a legal, theft. Will not a continuance of this practice tend to lower his standards of honesty? I believe it will, and that sooner or later we may expect almost anything from one who started out as an honest man but became the victim of a dangerous custom. In some banks these "kitties" are not even locked up at night with the rest of the bank's cash. I have seen cases where all employees, even the janitor, had access to this money and took full advantage of this opportunity.

Consider for a moment a somewhat weaker character than the teller just referred to—and there are many of this type employed in banks—a man working for a small salary and, in all likelihood, living beyond his means. He cannot stretch his salary from one pay day to another. On leaving the bank he discovers he is short of carfare or lunch money, and thereupon

"borrows from the kitty". He later receives his salary, from which, of course, he intended to make good his loan, but as no one saw him "borrow" from the "kitty" he sees no reason why he should put it back. Probably he knows others are "borrowing" in this way, or possibly feels it is not the bank's money and he has as much right to it as the bank, or it may be he simply forgets to put it back. It is unnecessary for me to picture the result of a continuation of this procedure. The bank that permits the maintenance of a "kitty" under any circumstances, no matter how small, or how its use is regulated, has only itself to blame in the event of a defalcation, for the existence of a "kitty" has started many young men on the downward path. I have seen cases where the regular small expenses of a bank were paid out of the "kitty". A case in mind is where a junior officer was too indolent to make out a charge ticket charging expense

account and simply paid small expenses out of the "kitty," which required no bookkeeping entry. The writer has been informed that some twenty-five years ago these "kitties" actually ran "wild" in some of the large New York City banks, that the employees divided "profits" at a regular monthly dinner, which was also paid for by the "kitty". Every loose dollar they could possibly secure honestly or otherwise was thrown into the "kitty".

The routine in most of the large New York City banks has been perfected to such an extent that it is doubtful if a "kitty" exists in any of these institutions today. Where "kitties" are tolerated at all, who knows to what extent they are manipulated? There is no doubt that much serious trouble has been directly traceable to "kitties". It is often difficult for an examiner to detect the existence of a "kitty," as the employees try to conceal it as far as possible, and

sometimes it is necessary to call it by several names and ask many questions before the "kitty" is actually produced. This fact alone proves that even the employees themselves realize it is a practice that can be criticized and for that reason hesitate about admitting its existence.

The proper way to adjust over and short differences is for a difference account to be carried on a general ledger. When a teller has a difference he should make out a charge or a credit ticket, as the case may be, to this difference account, which goes to the general ledger bookkeeper for posting. The bookkeeper should not post any difference ticket unless it bears the initials of an officer, and it should be the duty of a teller responsible for the difference, or in whose department it occurred, to present this ticket to the officer for his initial. In that way the officials will have a direct line on the kind of work their men are doing. Under this method all differences are re-

corded, and there is no cash around loose for tellers to manipulate. The procedure of a teller approaching one of the officials to have a ticket initialed which represented an error would have a tendency to make that teller more careful in the future, whereas a "kitty" never would. This procedure should apply to *all* differences from one cent up. This may cause a little extra work, but an ultimate defalcation would cause much more. The custom of some banks to have a teller carry an over and short difference account in his daily settlement sheet can also be criticised, for this method is only slightly different from maintaining a "kitty".

Employees' Accounts

No employee, either clerk or officer, should be permitted to maintain an account in a bank in which he is employed, as this practice has also been the starting point of many defalcations. Arrange-

ments should be made by a director with some friendly institution to carry small personal accounts for his employees and reciprocate by offering the services of his bank in the same capacity. It would be advisable for a director to occasionally drop in at the other bank and inspect the paid vouchers on accounts of his employees. This practice could not justly be called an inquisitive one, as the purpose would be for the benefit of a public institution and even for the well being of the employees themselves. This is usually a good way of keeping in close personal touch with an employee's private life, which, without doubt, has considerable bearing on the conduct of his position. Under no circumstances should an officer or employee be permitted to draw checks on his institution without an account on the ledger. This is often done with the idea of meeting the check with cash when it comes in. It must be borne in mind that there are many dis-

honest ways of taking care of such checks. Sometimes they are met with cash, but oftentimes they are not. They may be charged to some customer's account and then destroyed or extracted entirely, which would result in an unfound difference, or they may be carried in cash items until money or another means to offset them is obtained. When I say that no employee's account should be carried by a bank in which he is employed, I have in mind cases where credits were deliberately misposted and amounts transferred from other accounts to that of the employee, etc. Furthermore, it opens the door for the crediting of various profits of the bank by officers to their own accounts, etc., which has often happened. The writer has known banks which would not permit employees to carry accounts, yet they would allow them to draw checks for small bills, under the assumption that they were being properly taken care of with cash when

they came in. This assumption is not always correct.

Unclaimed Deposits

It occasionally happens, particularly in large and busy banks, that a deposit is taken in for an account which cannot be located on the ledger. The receiving of a deposit like this will often happen in a rush of business and is usually caused by the depositor sending some inexperienced person to the bank, who either goes to the wrong bank or puts his own name on the deposit ticket. The teller may not notice the name on the ticket if he is very busy, or he may not even know the names of all the customers, and, therefore, does not hesitate to accept a deposit bearing a name which is unfamiliar to him. The purpose in mentioning this matter is to warn banks against allowing deposits of this nature to be kept in the teller's cage until someone claims them, which seems to be the usual

way banks have of handling funds of this nature. This is a bad practice, as money held aside in this way usually becomes a "kitty," or it may disappear entirely. Any money which is held over or carried along without strings on it affords the opportunity to "borrow". Deposits of this nature should be immediately credited to a suspense account on the general ledger, to be charged should a claim ever be made.

Safe-Keeping of Customers' Securities

Most banks are burdened with the custody of securities left with them for safe-keeping by customers who do not rent safe deposit boxes. This practice is one of the results of the war, as it was generally started during that period to care for Liberty bonds purchased by persons who owned no other securities, and, therefore, had no reason for renting a safe deposit box. In fact, it was an inducement offered by many banks to the public in order

to further the sale of Liberty bonds. During the war emergency most banks suffered with the employment problem, and routine work just hobbled along as best it could. Business multiplied fast and the work of aiding the Government to finance the war was no small additional task. As these bonds poured into the banks for safe-keeping, various attempts at systems were installed to provide for them. Most of these systems were devised with no idea to what extent this class of business would reach, and during the rush of work, handled by inexperienced clerks, even these attempted systems were carelessly kept and often ignored. As the war period passed the public took advantage of this privilege of leaving securities at the bank for safe-keeping, and consequently it is common now to find not only Liberty bonds but every kind of security, even to jewelry, carried by banks in this department. In a very large percentage of the

banks it is impossible for an examiner to verify these securities, and in many cases it would be a waste of time to check the securities on hand against the bank records, because when these records were put in use the idea of a defalcation was apparently remote.

It would not be advisable to go into detail along these lines, but it is enough to say that an examiner would encounter serious difficulty in endeavoring to ascertain whether or not a discrepancy existed in this department as a result of past looseness. It is regrettable that no new system, however good, would be practically applicable to past transactions. Banks can only hope for the best in this regard and show that "it is never too late to mend" by nailing down this department from now on. Whatever system is installed it should be based on an inventory, taken immediately, of all securities on hand in this department. Stub records should be kept of all future

transactions and receipts given to customers *should bear serial numbers* corresponding with the numbers on the stubs. These securities should be kept under restricted access, and the same care taken of them that a bank usually takes of the securities which it owns. It would be preferable to have these stub records in a bound book form so that an examiner would have a guide by means of which every outstanding or surrendered receipt could be taken into consideration.

The writer believes that securities owned by customers and held by banks for safe-keeping are a direct liability of the custodian in spite of some arguments to the contrary.

Cash Items

The term "cash items" is applied to checks, charge tickets, memoranda, etc., for which cash has been taken or for which cash should be substituted or made good in

some other way. These items are actually held in suspense by means of having them counted for actual cash instead of being charged up to their proper places. These items should receive close scrutiny, for it will usually be found that they are "not good" or uncollectible and, therefore, carried along as cash for reasons which should not be accepted too readily.

There are few defaulters, indeed, who have not "shuffled" the cash items during some stage of their career.

Some of the large New York City banks have hard and fast rules against the carrying of any cash items whatever. Every item is charged to its proper place regardless of the consequence.

Many of the smaller banks, particularly out-of-town institutions, could not hold strictly to a rule of this kind, but should insist upon a permanent record of these items being kept in a book for that

purpose. This record should be in a bound book, written in ink, with sufficient detail for an examiner to identify various items for months back.

The majority of banks at present keep a daily record on a scrap of paper, showing amounts only, and destroy the same the following day. This custom furnishes many opportunities for a defaulter or even one who does not actually embezzle but just indulges occasionally in a "shady" transaction.

Nail the opportunity down at once by demanding a permanent record of cash items and verify the total of these items with the total used on the daily settlement.

Don'ts for Directors

Without describing in detail any further opportunities existing in many banks, the writer suggests that the following "tips" under the heading of "Don'ts" be given some serious consideration.

These "don'ts" cover practically every form of a defalcation at some stage of its existence. If this advice is heeded and if rules and regulations based thereon are rigidly enforced by the directors, the possibility of preventing involved defalcations will not be remote.

DON'T lose an hour's time in protecting your interest or savings department as herein suggested.

DON'T permit the existence of what is known as a "kitty".

DON'T fail to safeguard securities left for safe-keeping by customers. This is a liability of yours.

DON'T permit employees to carry accounts in the bank in which they are employed and don't, under any circumstances, allow employees to draw checks on their own bank, when they have no account.

DON'T allow unclaimed deposits or other loose ends of money to lie around

tellers' cages or the vault without some control on the books of the banks.

DON'T permit trading on the stock market by either officers or employees for their own account.

DON'T require tellers to make good short differences. Adjust them as suggested under heading of "kitty".

DON'T ignore the private life of your employees.

DON'T fear being considered over-inquisitive.

DON'T fail to pay your employees a living wage.

DON'T neglect to watch the outside enterprises in which any officer or clerk might be interested. Many banks have been wrecked by this neglect.

DON'T permit the promiscuous paying against uncollected items unless initialed by an officer who can be held accountable for any loss sustained in this way.

DON'T forget to watch the account of the man who stands chatting too long with tellers or the pest who is forever handing in cigars, etc.

DON'T forget to inspect your ledgers for check kiting.

DON'T allow officers or employees to make loans from their personal funds to customers.

DON'T think you can use sharp practices yourself without the youngest employee in the bank knowing it. He may be looking up to you as an example, and copy your practice in a small way.

DON'T think what happens behind closed doors in the directors' room never leaks out, particularly the things that should not. Employees always seem to learn these things in a mysterious way.

DON'T notify the executive officer of the bank when you are going to make an examination, and DON'T worry before you start as to how long it will take. Roll

up your sleeves and go to work. Tackle the job as though you were working for a living or else resign your position. DON'T forget the people who are depending upon you to protect their money.

DON'T fail to learn all about the contents of any safe deposit box kept by officers.

DON'T depend too much on official examination. Remember your own responsibility as well as that of the examiner.

DON'T think your bank is too small to adopt precautions. The writer knows of one bank like this which employed only one man. The bank later found all of their assets in the showcases of a jewelry store owned by this employee's brother.

DON'T accept explanations of irregularities too readily, however plausible. Investigate fully. A case in mind is where a teller showed a shortage of $9,000, and with the help of a friendly customer made

this appear as an error. The directors believed the story of this teller and customer and the matter was dropped. One year later this teller pleaded guilty to the embezzlement of approximately $200,000. At the time of the $9,000 irregularity there existed a shortage of approximately $100,000 which he had well concealed.

DON'T discharge a man on suspicion. Change his position or give him an opportunity to seek other employment or keep him under close observation. Many a man's life has been ruined in this way. Be as fair to him as you expect him to be to the bank.

DON'T fail to see that all paid notes are properly cancelled with a large stamp across the face and that all payments on account of notes are endorsed.

DON'T fail to audit the receipt of interest on notes, mortgages, bonds, etc., and verify the principal in a few cases where

the latter appears unchanged for a considerable time.

DON'T fail to verify the signature on large notes.

DON'T fail to watch transactions with your bond houses. Some of these have been known to give concessions to officers.

DON'T take an adding machine list for granted in your examination. Re-run this list yourself. *Don't* forget a total can be thrown in and still not print.

DON'T let one man hold down two jobs. This is false economy.

DON'T forget to change your bookkeepers around occasionally.

DON'T allow erasures on any books or records. Have mistakes crossed out, but let original entry stand. Erasures might cause your bank to lose a law suit and also allows your bookkeepers to get into bad habits.

DON'T forget that deposits on check accounts can be held out and substituted

as well as those on savings accounts, so *don't* forget to look over your total deposit tickets on any given day and check up on the dates, handwriting, etc.

DON'T forget to reconcile your accounts with correspondent banks occasionally. When the account verifies with exceptions don't drop the matter there, but *see it entirely through these exceptions.*

DON'T allow the over-certification of an account and don't allow one teller to handle the complete transaction regarding certified checks. Don't forget he can manipulate outstanding items.

DON'T forget to have outstanding certified checks proved up monthly, have registers ruled off monthly and items that are out entered in red ink. Don't forget to have certification register a *bound book.* A numbering machine to stamp each number on check and repeat same number in register is a good idea.

DON'T allow tellers to carry cash

items. Charge everything to its proper place immediately and don't allow tellers to carry checks or other items along in their cash for the accommodation of customers. Don't allow clerks or tellers to carry memos for money advanced in their cash. Don't forget that these tickets could be pulled out or destroyed and the same offset by an over difference at window. A teller could pilfer in this way without actually going through the act of putting money in his pocket.

DON'T allow a teller to make "change" for himself or cash a check for himself. Don't forget he can deliberately make a "mistake" in his favor. If a teller is observed moving his hands from his pockets to the cash drawer or vice versa, question the act immediately. This is too frequently ignored. Tellers have been known to carry a book which they were reading into the cage and take the same away with them nights, while during the

course of the day paper money was slipped between the pages.

DON'T permit officers or employees to keep envelopes, boxes or other containers with personal property therein in same compartments with assets of the bank.

DON'T allow securities that have been used for collateral purposes to lie around loose or repose in collateral loan files after loans have been paid. These securities should be transferred to the safe-keeping department when not surrendered to customers upon payment of loans, even though the customer may be expected to make a new loan and use the same collateral.

One of the most important DON'TS for an officer is:

DON'T make any statements to an examiner which are not strictly in accordance with facts.

These "don'ts" do not by any means comprise the entire duties of directors.

They are merely pertinent in the matter of preventing defalcations. There are a number of books published pertaining to directors' duties, how to examine a bank, etc. These volumes should be referred to for further information.

When Desire and Opportunity Meet

The writer will not attempt to describe all the swift happenings upon the "break" of a defalcation, or the feelings of those who are directly or indirectly involved, but will say a few words on this matter for the benefit of those who lack the necessary imagination.

Some small irregularity may by chance or otherwise present itself. Then the possibility of real trouble looms up. An arrest is made, the newspapers carry headlines, heavy withdrawals are made, then possibly another arrest with more withdrawals and more headlines. Each day upon investigation the defalcation grows.

Now the directors are fully awake; they have visions of a complete crash, the loss of much money personally, courtroom scenes and trials, the loss of friends and the never-ending publicity. Possibly some of these directors might actually picture themselves behind prison bars. They are really staring ruination in the face, perhaps for the first time in their lives. The mental torture to those interested at the first break of a large defalcation must be hard to endure. Should the defalcation prove to be a small one, the visions of ruination would, in all probability, remain visions. If, on the other hand, the shortage assumed considerable proportions, sufficiently large, for example, to impair the capital and make necessary the closing of the institution, then these visions would become stern realities. Let not the director, who thinks himself a "big" man with money, friends and influence, smile at this picture, for he may little real-

ize how easily he may be placed in this very position with nothing visionary about it.

I will cite one instance to show the narrow escape of some bank directors. A certain bank carried a blanket bond for $100,000; a defalcation occurred, which, after investigation proved to reach the extent of over $300,000. In just twelve hours' time one of our well-known surety companies presented their check for $100,000, with practically no questions asked. The matter ran along for a few days when the surpervising authorities, realizing the precarious condition of the bank, demanded that the directors make good the remainder of the shortage. These men were the ordinary type of bank directors—intelligent, successful in their own business and were not only reputed to be wealthy but were what is generally known as rich men. They presented a pitiful sight in their feverish efforts to raise a large amount of cash. Their friends ran

for cover, their own assets were not liquid, and their influence was worthless at a time like this. The supervising authorities limited these directors to forty-eight hours in which to raise the amount of cash under threat of closing the institution. One at a time they "threw up their hands" like so many helpless children, but fortunately for them all the extremely wealthy family of one of them came to their rescue and assisted in supplying the required amount. How many of our bank directors have these wealthy families behind them? They themselves are more often the wealthy member of their particular family. The authorities were not "bluffing" in their threat to close this institution, for they were playing safe themselves. To have permitted this bank to remain open in its dangerous condition would have cost these men their jobs at least, let alone the condemnation of the public. If the money had not been raised in the required time

and the institution was closed, a great loss would have resulted thereby to thousands of poor people, and prosecutions many and swift would have been demanded by the public. To the writer's personal knowledge the prosecuting authorities would have had little difficulty in involving criminally every individual director in this institution. These men could have at least been indicted and compelled to stand trial. Possibly there would not have been convictions in the case of each and every director, but who can tell what a trial jury will do? The chances are that in a flagrant case of this kind where public sentiment demands punishment, a jury might convict on general principles. Suppose, under these circumstances, a man does succeed in obtaining an acquittal; he is branded for the rest of his life as having just barely escaped prison.

I hope I have made it plain that it is quite possible for an honest and conscien-

tious bank director to arise some morning and find himself in a very difficult position.

The Purpose of Official Examinations

All banks are subject to some official supervision and are accordingly examined from time to time by either the national or state bank examiners. The public and even the directors of many of these institutions do not fully realize that the duties and procedure of these examiners are clearly defined for them by the authorities and that they are primarily to make examination as to the solvency of the bank. While there seems to be no hard and fast rule governing the time spent in each institution, the circumstances usually require an examiner to move on to his next assignment as soon as he ascertains the true condition of the bank.

The possibility of an examiner detecting a defalcation is quite remote unless the general atmosphere of the bank arouses

his suspicion or unless he discovers some irregularity during the course of his examination. Doubtless there is a sigh of relief on the part of most bank directors upon the conclusion of any official examination and a general feeling that all is well. These directors are not only self satisfied but their confidence in the officers and employees is automatically strengthened, yet how often is this confidence misplaced. There are many bank directors who do not fully realize the responsibility, and I might add, with emphasis, the liability of acting in this capacity. I have in mind the very large percentage of directors who have arrived at the graduation class in some other line of business and know little or nothing about real banking practice. They have aspired to be classed as bankers in their respective communities and naturally when the opportunity to serve on a bank directorate presents itself they grasp it blindly, but always with their confidence in official

supervision uppermost in mind. These directors do not realize that the possibility of a defalcation should always be in mind. Directors often disapprove of some improvement in the routine of the bank, or some suggestions made by a well meaning officer or examiner simply because it may involve some additional expense. They feel that everything has been all right in the past and that the chances are it will continue to be so. I do not profess to know what is in the minds of these men when they take this attitude, but I assume they are relying on the regular official examinations to detect any irregularity before it reaches dangerous proportions.

Bank directors do not stop to think that most of the examiner's attention is taken up along other lines, and that usually a defaulter, being at least of ordinary intelligence, has taken the preliminary trouble of matching his wits against those of the examiner, and consequently will

cover his tracks as far as possible. It is usually the chance mistake that the defaulter will make which leads to his discovery.

The confidence displayed by the public in our financial institutions is based in the first place on the official supervision governing these institutions, and secondly, on the reliability of the men composing the directorate. Regarding the possibility of a defalcation both the public and the directors rely on the official examinations, notwithstanding the fact that the discovery of a defalcation is only a secondary purpose of the examiner and not in a direct line with his duties. The public can be excused in this misconception, but the director never. It is his duty to conduct the business which he is supervising in a manner which will reduce to a minimum the possibilities of an embezzlement regardless of expense, and to know as a result of his own investigation that no irreg-

ularity exists. This would be difficult in the case of a director who had spent most of his life in some other line of business, and these things should be considered by a man who seeks to become a bank director.

Bank directorates cannot be composed entirely of bankers, as the management would not be well balanced. It, therefore, behooves the layman to make every effort to educate himself to the duties of his position and to always have in mind the possibility of a defalcation. Unless this unpleasant thought becomes a subconscious worry he is apt to be more or less careless concerning the adoption of preventive measures and may become overconfident, through close association, in those whose moves should be scrutinized. Without this thought in mind he may not grasp the real importance of suggestions made by examiners who, through necessity, may be more or less conservative in their statements.

The reader will, no doubt, ask why it is not made the duty of examiners to also look for defalcations as well as to the solvency of a bank. I answer this question by stating that the act of ferreting out well concealed defalcations might take weeks or even months. It would entail considerable expense, and everyone in the bank would have to be under suspicion and gradually exonerated by the process of elimination. The examiner would have to delve into the private life and personal affairs of all officers and employees, in addition to doing much auditing work which might show no results. This process would undoubtedly be resented by banks and their employees where no irregularities existed, which, fortunately, is the case in the very large majority of banks. Such procedure would cause conflict between the banks and their supervisors and it is quite essential that harmony as far as possible should exist between the banks and

the supervising authorities. Would it not be better to forestall the possibility of a defalcation than to have examiners or anyone else hunt for one which may or may not have occurred. From the foregoing it would seem like a difficult problem confronting bank directors, and the quicker these men realize their difficult positions the better. They should adopt all modern systems and preventive measures now in use as far as possible, and instantly stop practices, however small, which are known to be dangerous. Methods running along in the same old rut, if not safe, should be corrected at once, as the peaceful past is no guarantee for the future. Suggestions made by bank examiners should, at least, be given serious consideration and not passed over lightly or totally disregarded, as is often the case.

Many bank officers and directors are too ready to feel that examiners are unduly particular in criticising small techni-

cal irregularities, but the old adage of "mighty oaks from little acorns grow" is indeed applicable to banking procedure.

The Value of Directors' Examinations

With very few exceptions most examinations conducted by the directors themselves might properly be considered jokes. The writer has, on many occasions, heard the executive officers laugh and joke about these examinations, and pass it off by saying they were only made to comply with the law. In many cases the examining committee of the directors actually consult with the officers as to the time it would be convenient to make an examination. Often these directors will ask the officers as to how to proceed and how long this or that job will take, etc. As far as defalcations or the prevention thereof is concerned these examinations are truly worthless when conducted by the directors themselves.

Let us consider banks in which the directors employ accounting firms to make these examinations for them. These examinations are, of course, very much more efficient and beneficial to the institution, but the accountants are usually instructed just what to do when they are employed. They are not usually given *carte blanche* to dig into the vitals of the bank nor are they instructed to search for defalcations. Many of these men, although expert accountants and auditors, are not familiar with the workings of a criminal mind. They are experienced in constructive accounting and take the books and records as they find them. Books and records cannot always be taken for their face value when hunting for a defalcation. Many accountants and official examiners would not be able to discriminate between a wilful false entry and a mere clerical error. Examinations, whether official or by public accountants, cannot be de-

pended upon to unearth defalcations. The moral effect, however, on the employees does aid in prevention. Directors' examinations, when conducted by themselves, usually fall short of even having a moral effect on the employees.

What Kind of a Banker Are You?

Three large banks of equal size were visited consecutively by an investigator, who noticed that in each of these institutions the same opportunity for a defalcation existed. This condition was pointed out to the presidents of these banks with the following results:

The president of the first bank has and deserves the reputation of being a good banker. He is what is commonly known as a "live wire". He made the statement that he would correct the condition called to his attention immediately, even if it became necessary for him to reconstruct his entire banking floor.

The president of the second bank visited said: "Oh, let the surety company worry about that." This man was informed that a loss might run over the amount of his blanket bond and the directors would be compelled to make good. He replied to this suggestion by stating that he would have his blanket bond increased immediately. This man stands out as one of the leading citizens in his community, looked up to and respected by almost every one. His true colors, however, show that he does not deserve the reputation which he enjoys. He is the type who is helping to maintain high rates on surety bonds and packing the penal institutions to the doors. This is not a rare instance, as there are many others who show a similar attitude, although not quite so frank.

The third bank was presided over by a staunch but narrow-minded churchman. He believed in employing only those who

were members of his church, regardless of their habits, ability or character. He took the attitude that if his employees were members of the same religious denomination they were not only honest men now but would remain that way. Just imagine this person in full charge of a $10,000,000 bank. It was indeed difficult to reason with this man. He simply would not see the danger explained to him, but continually fenced for reasons why he should not correct this condition. His arguments were so weak they are not worthy of mention, but they indicated that he was just as selfish and stubborn as he was religious.

Religion is one of the mainstays of the world and we could not go far without it. We should understand, however, that religion will thrive better outside of the modern business house and that its aid in preventing bank defalcations in the past has been insignificant.

At this time it would be appropriate to mention the president of another institution who takes the attitude that a defalcation in his bank is impossible because he "looks up the references of his employees with great care". Just think of this man occupying the president's chair with a partially developed mind. The proper place for this paragraph would be in a comedy on bank defalcations, if such a thing were possible. To repeat a phrase used elsewhere in this book, he does not know that "the bank defaulter is usually an honest man who becomes a thief *after* he obtains employment in a bank".

It might be well to refer at this time also to an instance where a board of directors gave a vote of confidence to an employee, retained him in his position and even aided him in many ways to escape prosecution when he was caught "hands down" in a flagrant irregularity. This is not a very unusual happening. The writer

knows of three specific cases in three widely separated parts of the country similar to the instance just mentioned and has heard indirectly of others. Actions of this kind may take place in a spirit of defiance to the examiners and other public officials, or possibly because of some personal ties the person involved has with some member of the board. There are no words in our vocabulary strong enough to condemn such a procedure.

Collusion Defined

The word collusion is often misused by bankers, examiners and auditors, and, consequently, the statement containing the word is liable to be misinterpreted. In referring to a bank defalcation, the word collusion should be preceded by the word criminal, for it is possible for two or more persons to agree to do a thing or to collude or enter into a collusion to do something which is not

criminal. But with a theft intended it must be a criminal collusion or what is legally known as a conspiracy. Suppose an investigator or a bank auditor were to inform a bank directorate that a defalcation in their institution would be very unlikely owing to their systems, etc., without collusion. These directors would naturally assume that criminal collusion or conspiracy was meant and would probably feel safe in the assumption that no two or more employees would actually get together and agree or conspire to defraud the bank. Suppose, then, that a defalcation should occur engineered by one man and aided by another clerk or an outside party who had no intention of assisting in a theft or who had no knowledge of the other's pilfering. The directors would say they were not informed that this was possible, and the investigator would cover himself by saying that this was what he has entirely too broad a meaning when it

is used in connection with the personnel of a bank. A case in point is that of a defaulter, who covered his shortage by manipulating customers' pass books. He instructed a very young clerk as to the necessary adjustments to be made in these books. The defaulter was older, held a higher position and was of a stronger personality. He exercised his influence over the boy and was thereby rendered assistance which made it possible for him to cover his shortage for a long time. Could this be called "collusion"? Yes, but certainly not criminal collusion or conspiracy, and that is what is meant when the word is used in bank routine. This boy never dreamed of the result of his acts. Another case involved a girl bookkeeper, who was instructed to make false entries on her ledger by a teller who did not have meant by "collusion". The word alone access to the ledger. This girl could not

think for herself and was too inexperienced to know that she was doing wrong. She actually covered the teller's shortage for him, yet this could not be called criminal collusion. It must be remembered that a defaulter's mind is always on the alert. He is thinking several paces ahead of the honest clerks around him. He is desperate and will take all kinds of chances. His desperation will impress the inexperienced clerks around him as being strength of character, and the attitude that he thus assumes is capable of having many things done around the bank by unsuspecting young employees which would aid materially in concealing his defalcations. Those responsible for rendering this aid under the circumstances could not be considered a party to a collusion morally, although it would be a simple matter to legally connect them as aiders and abettors in a crime.

Illustrative Cases Disproving Common Opinions

Some readers will feel that it would be difficult for an innocent man or rather a man with no criminal intent to actually become a principal in a defalcation and violate the banking laws flagrantly, and some will feel that they are competent to judge their employees in the matter of defalcations, taking into consideration their character, habits, length of service, etc. For this reason the following cases are related which might cause some change of opinion.

The first case will show how simple it is for a bank officer or employee to become involved in an irregularity, without criminal intent and against his own wishes. The fundamentals of this defalcation are quite common and have been the cause of many large and involved irregularities. The act of an officer becoming over-friendly with a customer and grant-

ing of many little favors forced the desire upon this officer. The incompetent board of directors, who knew nothing whatever of banking laws or routine and cared less, and their over-confidence in one man together with many loose and dangerous customs, furnished the opportunity.

A small country bank was organized by reputable, wealthy and hard-headed farmers, and, as is often the case, a young man with very little banking experience, a former school teacher by profession, was appointed cashier. This young man was of high character, clean cut and a very likable fellow. He was married to a very fine girl from one of the old families in the community. This couple lived in quarters adjoining the bank and seemed to enjoy the slow and rather monotonous existence of living in a far-off country town. Their chief pastime was church on Sundays, with an occasional day's fishing through the week, and during the long winter

evenings they would engage in a friendly game of cards at a neighbor's home. This young man had not purchased a suit of clothes in three years, as he had no need to keep in style and could save money by actually wearing out his old clothes. This couple was saving about 70 per cent. of their income, as their combined wants were few and expenses almost nothing. The cashier was, of course, anxious to build up the business and get as many new accounts as possible. With this end in view he visited an adjoining town to look up an acquaintance of his who had just started in business. This acquaintance was a clean-cut young man, shrewd and probably honest at heart, but one who would stop at nothing which he considered legitimate to further his own ends. This friend was a very much better business man than the cashier was a banker. He was looking for a bank to do business with, particularly one in which he might obtain accommoda-

tion through his acquaintance. Therefore the securing of this new account was easy.

In a very short space of time things began to boom for this young business man and he was pinched for working capital. He did not have sufficient funds to pay a certain draft for a carload of merchandise shipped to him, yet he needed these goods to supply his trade. He thereupon persuaded his friend, the cashier, to loan him on the bill of lading so that he could get the merchandise, promising that he would realize on the same immediately and then pay the draft. The cashier was anxious to hold this man's account, thinking it would eventually be a large one, and he also wanted to accommodate him as much as possible because of their friendship. He thought he was not taking a very great chance by complying with his friend's request. However, this draft was never entirely paid. The business man

claimed he had to sell some of the merchanise on time payments and made other excuses, so that consequently the cashier had to make him a loan to cover the deficiency. Business grew in leaps and bounds for the young business man, and just as rapidly his working capital was being tied up. He would insist upon further accommodations in the form of loans and other favors which he did not consider illegitimate, but were nevertheless demanded under the pretext that he might "fail" if they were not granted in which case the greater part, if not all, of the loans already procured would remain unpaid. In the beginning the cashier did not want to see his friend fail, as the bank would lose a customer and the small amounts then owing. Consequently he kept on accommodating him, thinking each time would be the last and that some of the proceeds from his enormous sales would soon be used to liquidate his in-

debtedness. However, the proceeds were used in the expansion of the business, and the bank was not only forced to wait but to keep on advancing under threat of losing what they had already advanced. When the amounts loaned in the regular manner began to exceed the limit prescribed by law, the cashier felt that he was forced to make false entries, false reports to the authorities, conceal evidence of additional loans, and manipulate other accounts to the advantage of his friend's account. In fact, he flagrantly violated the law in every possible way to conceal the large amount which his friend was using to finance his business. The visit of a bank examiner and the subsequent arrest of both men was the outcome of this situation, fortunately in time to save the bank. This small country bank was compelled to stagger along with a loss of approximately $50,000. The closest investigation did not reveal how the bank cashier

profited personally in any way, but he was certainly criminally negligent, being ignorant of banking practices and having ignored the banking laws entirely. The directors were so confident of this young man's ability that they paid no attention to matters that he brought before them at meetings, but were more apt to talk about automobiles or crops. Banking laws, banking routine and general business practices were absolutely foreign to them. Strange as it may seem, the writer believes that the customer in this case, or, legally speaking, the aider or abettor, likewise had no criminal intent of injuring or defrauding this bank. Surely there was no criminal collusion between them.

Probably some bankers who may chance to read this book will look over his employees and say to himself that "there is not a man in my organization in whom I have not the fullest confidence." This is a pleasant way for him to feel, but rather

dangerous for himself and for the public who have money in his bank. Will he be able to feel the same way six months from now? The longer one deals with bank defaulters, the harder it is to discriminate by merely looking over the men or being acquainted with them. The guilty ones are usually the ones whom we would least suspect.

A strange case is that of a young man who defaulted to satisfy the ambitions of his mother, a very fine old lady. This case occurred in a bank in a large city, and the young man had advanced himself to the position of a junior officer. No defalcation was known to exist in this bank and not the slightest irregularity had ever been found, although the examiners had made very careful examinations at irregular intervals. This young man was a member of a very highly respected family, enjoyed the confidence of a host of friends, and was engaged to marry a young lady of

high standing. After a thorough investigation it was established that he had no bad personal habits of any kind. He did not even smoke, associated with the very best people, spent his evenings at home reading, used the best language, and, in fact, he appeared to be a gentleman in every sense of the word. His manner was genteel, he was clean cut and good to look at and, all around, a fellow whom you could not help liking. In conversation he was direct and interesting and always looked his audience unflinchingly in the eye.

During an investigation of certain criminal acts in another bank in which this young man was in no way connected, the inference was drawn that possibly the young man referred to was interested in the stock market, and with this idea in mind he was requested to present himself for an interview by authorities who were investigating the irregularities at the other

bank. During this interview the young man's personality was, of course, entirely disregarded, and many pointed and personal questions were put to him in rapid succession. He answered every question, carefully retaining his composure. He stood up well under what was really an unwarranted grilling. A little nervousness was noted, but this was to be expected under the circumstances. The interview ended with the investigators gaining nothing except having made an impression on the young man from their questions that they knew a great deal more about him than they really did, but as a matter of fact they only knew what he had told them. These investigators then communicated with the chief bank examiner and suggested that he make an early examination of the bank with which this man was connected. Consequently, the next day instead of the usual two examiners appearing on the scene, four walked into this

bank. Had this young man kept his nerve he would have been free today, for he concealed his defalcations cleverly for a long time. With his grilling of the previous day fresh in mind, followed by the appearance of a double force of examiners, he weakened and before the examination started confessed to the misappropriation of approximately $50,000. After his arrest he told the writer that the only motive he had was to become rich and principally for his mother's sake, as she was continually spurring him on to get ahead in life and make more money, never dreaming, of course, that he would deviate from the straight and narrow path. He claimed that he had worked so hard in the bank day and night to advance himself that he had become run down physically, and that he was only tempted to use the bank's money to finance himself in Wall Street through his weakened condition. Of course, a defaulter always has an excuse,

and this should, therefore, be taken for what it is worth. However, I believe that this case will tend to show that a man's personality, habits and character are no proof against defalcation.

Another unusual case is that of a man over 70 years of age who had served 50 years of his life with one institution, and after all these years of service commenced to steal. Upon investigation it was found that this old man had no bad habits, was not a spendthrift, but simply used the money which he stole to pay his regular expenses—grocers, doctors, medicines, etc.—as his salary had not kept pace with the increased cost of living. This case occurred in a small out-of-town bank where the entire working force consisted of the old man just referred to and a young girl. This young girl was also stealing and using the money to buy such luxuries as many young girls dream of. This unusual combination of defaulters

was stealing individually with no criminal collusion between them. Whether either had knowledge of the other's pilfering or not it would be hard to say.

Bank defalcations seem to be on a par with some physical diseases from which no one is immune.

What to Do in the Event of a Defalcation

Most bankers would know what to do in the case of a defalcation when the man responsible makes his departure. This man has relieved the directors of the task of fixing the responsibility. The directors would then go through the necessary legal procedure, notify the surety company, have an audit made, and possibly they would then adopt some means of preventing a repetition of this particular kind of a defalcation.

The most difficult cases, however, are those where the guilty person does not depart and does not acknowledge his com-

plicity by any unusual action, but remains at his post to see what happens and to protect himself to the last straw. These cases, particularly where the actual cash is stolen and where the most exhaustive audit will not reveal the guilty party but simply the amount of the theft, must be worked on by means of interrogation. Interrogation in itself will mean nothing unless properly handled, and the writer suggests a method which has proven successful.

Before any employee is questioned the directors should learn personally or through hired investigators as much as possible about the private life and habits of each employee. This information should not be in the form of gossip or hearsay, but should be facts in writing. These facts should not be obtained from fellow employees, but from outside sources, and should relate to any other income the employee might have, his bank account, paid vouchers, his friends, clubs,

how most of his spare time is employed, his home life, and approximately what it is costing him to maintain his home, etc., and his movements just prior to the break of the defalcation in particular. Up to this time the defalcation should not be discussed in any way with the employees. Armed with these facts at least three directors should take their places in the directors' room and call in one employee at a time. Have him occupy a chair directly facing the directors with plenty of light on his face and begin to question him in a very quiet and friendly way. These questions should be founded on his life at a time years before his employment, and very gradually lead up to the present time. The interrogator should gradually become more and more aggressive and not say "did you do such and such a thing," but say "you did such and such a thing" and "why did you do it". He will deny it quick enough if he did not do it.

These tactics will take a man off his guard, for he will not know just how much you know about him. Veil your questions so he may have a choice of answers. Do not be afraid of hurting his feelings, for at a time like this it is often necessary to embarrass the innocent to find the guilty. Repeat many of your questions reframed, giving him the opportunity to contradict himself. In fact, suggest answers with your questions which would be contradictions to statements already made. The quicker he gets angry the better, as he is then off his guard. The interrogator should also pretend to get angry. Remember, one of the chief purposes of this interrogation is to trap your man in a downright lie. Do not pretend to notice this lie at the time, but go through this formality with each man who might possibly be involved. This interrogation should be done all in the one day and night so as not to give those already questioned

an opportunity to prepare others yet to come. Every word, both questions and answers, spoken in this room should be recorded by a stenographer and preferably one who is concealed if possible. If untrue statements have not already been noted in the course of these interviews, study the stenographic notes and re-examine the man who has contradicted himself. Remember, your defaulter is also a liar; they have never been known to be otherwise, and it is up to you to trap him in a lie, for it is far easier to catch him lying than defaulting. Assuming that your interrogation has been successful in producing one who has told an untruth or flatly contradicted himself, this man should be brought back into the room after all the others for re-examination. Remember, this man has sacrificed his chances of any consideration by lying and he should now be hammered with questions right and left. Go at him tooth and nail, keep

up a rapid fire of questions, repeating, if necessary, your previous question over and over again. If he becomes belligerent you are on the right track and you should assume the same attitude. Above all things, forget time; keep at him all night, if necessary; forget your dinner; if you are growing tired and weak, remember that he must be twice as much so, and every hour that the interrogation continues he is growing more and more weak. Guilty knowledge or an admission is what you are after, and it usually comes before morning.

Plain Talk in Conclusion

With disturbing frequency articles on bank defalcations are appearing in the daily newspapers. Many readers dismiss these matters from mind, sometimes with the casual comment of "another good man gone wrong".

There is no reason for the layman to give these accounts any serious considera-

tion, as they are more or less unfamiliar with the routine "behind the scenes" in banks and naturally feel that defalcations occur because they cannot be prevented.

The public does not know that many of these unfortunate situations, in fact, a great many of them, possibly more than half, could easily have been prevented if there had been at least one director on the boards of these banks who was "up to his job".

When directors acquiesce in the existence of conditions which permit of the opportunity to default, they are not only placing themselves legally liable, but they are giving aid and encouragement to the defaulter, thereby becoming moral parties to the crime. A very large number of our banks might be considered fertile fields for pilfering. It is not a difficult matter to find a bank where conditions are so loose that they actually invite a defalcation.

Directors should remember than an assurance from officers will not prevent embezzlements. It is their duty to know, as a result of their own investigations, that every known precaution is made use of. Beware of the officer who scoffs at preventive measures suggested by bank examiners by saying there never has been any trouble, so why anticipate it?

Directors should not allow overbearing and the know-it-all type of officer to bluff them out of doing their duty. This officer may have something to conceal himself. It is almost amusing for one of experience to discuss the matter of defalcations with the type of bank officer just referred to, and there are many of them. Many of these men have never seen a defaulter nor have they ever been an interested party in a defalcation. They have no conception of how the criminal mind develops. In fact, they know absolutely nothing about an embezzler or his methods. It is almost

impossible to reason with some of these men when pointing out conditions in their institutions which usually supersede defalcations. They should be forced to correct these dangerous conditions without argument by their directors.

Many bank officers are suffering from egotism; some are inefficient; some lack experience, and many are just plain stubborn. The majority dislike being criticized or corrected and will not admit the possibility of a defalcation in their institution. When one does occur they tumble from the pedestal on which they have been placed by their own vivid imagination. In case of a shortage, directors should bear in mind that this type of officer, although the underlying cause, cannot and will not shoulder all of the responsibility. Their duty is plain and should be done regardless of any officers.

Bank directors are a class unto themselves. They reign supreme. Possibly

there is some similarity between them and the indolent boy in the family who has grown so big that no one dares to spank him. Usually it is not good policy for a bank examiner to talk to them the way many deserve, except in cases where their negligence has caused disastrous results.

The class of officers other than those previously referred to, the men of much training and experience, broad and open-minded, always ready to learn and improve, do not dare to talk to their directors the way they would like to, and yet they are not vested with sufficient authority to make any important changes on their own initiative.

There are few directors, indeed, who would not resent being talked to personally in the manner in which the writer has endeavored to arouse them through this volume.

Undoubtedly there is a crying need for this "straight-from-the-shoulder talk" to

bank directors and it would seem that this talk should be in writing so that these busy gentlemen could digest its contents during any leisure moments they might have.

There may be some who still feel that defalcations are matters for the surety companies to worry over in spite of what has been said herein to the contrary. Will these gentlemen, after laying this book aside, please be fair-minded enough to consider well their answer to the following question:

"Is it just for a bank which takes every precaution, a bank which thinks of safety first, last and all the time (fortunately there are many of them), to pay the same rates on fidelity bonds as the bank which 'invites' its employees to help themselves?"

When burglary policies are issued certain regulations must be complied with, and the rate is based in accordance with the risk, likewise with fire, life and all other

insurance except risks on bank employees. The free and easy manner of surety companies in accepting any and all bank risks certainly does not help to reduce the number of defalcations nor does it discourage institutions which are inclined toward loose and dangerous practices.

The very seeds which have been known to grow into large defalcations are herein pointed out. Advice as to eliminating the opportunity and guarding against the desire has also been given, and it is hoped that directors will profit thereby. May they look at their positions from a different angle, realizing their full duty, their responsibility and their ever-present liability.

No one can foresee what bank will be the next to receive unfavorable newspaper publicity, possibly to the extent of appearing in large and damaging headlines. Now is the time to forestall this possibility

by attacking the opportunity *today*—and the desire tomorrow.

There may be some directors who will feel that their institutions are too small to adopt modern preventive methods. These men should stop to think that possibly their bank is also too small to receive the money of the entrusting public and that it might be better for all concerned if the business were immediately liquidated. The smaller the bank the more reason for safeguards, as there are fewer employees and more opportunities to satisfy a desire to default than in the large bank.

It would be probably "chasing a rainbow" to try to stop bank defalcations entirely, but it is the plain duty of every bank director, to himself, to the public and to his employees, one of whom might become a defaulter, to correct conditions which invite and encourage crime. To be derelict in this duty would be a betrayal of public confidence.

Many penitentiary inmates are former bank employees, as we all know, and to hear the details of their particular cases, after they have had ample time to meditate and nothing to gain from false statements, would cause one to wonder if they themselves were entirely to blame. At any rate, the thought would occur as to how simple it might have been to have prevented their ruination had the opportunity to default not existed.

In pointing out to directors their full duty and in otherwise talking to them "straight from the shoulder," the writer has intended no disrespect, and trusts that this advice will be accepted in the spirit in which it is given, for after all, our one big and common purpose is to make a clean business cleaner.

Should the circulation of this volume result directly or otherwise in saving from an ultimate prison term a single individual

who may not really be a thief, but might become a victim of circumstances, the writer will feel amply remunerated.